Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Request to Update Default Compensation Rate for Dial-Around Calls from Payphones	))))))	WC Docket No. 03-225 RM No. 10568

COMMENTS OF AT&T CORP.

Paul J. Zidlicky
Joseph R. Palmore
SIDLEY AUSTIN BROWN & WOOD LLP
1501 K Street, N.W.
Washington, D.C. 20005
Tel. (202) 736-8000

Lawrence J. Lafaro
Stephen C. Garavito
Martha Lewis Marcus
AT&T CORP.
Room 3A225
One AT&T Way
Bedminster, New Jersey 07921
Tel. (908) 532-1841

Attorneys for AT&T Corp.

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Pursuant to 47 C.F.R. § 1.415, AT&T Corp. ("AT&T") submits these comments in response to the Commission's *Order & Notice of Proposed Rulemaking* ("*NPRM*").[1]

INTRODUCTION

There is no legitimate basis for the Commission to adopt the request of the American Public Communications Council ("APCC") and the RBOC Coalition (collectively, "Petitioners") to double the default rate for dial-around payphone calls from $0.24 per completed call to $.0484 or $0.49 per completed call, respectively. No modification in the compensation rate is necessary to promote "competition among payphone service providers" or "the widespread deployment of payphone services to the benefit of the general public." 47 U.S.C. § 276(b)(1). At bottom, the position of APCC and the RBOC Coalition is that because consumer demand for dial-around payphone services has fallen and continues to fall significantly (while, they claim that costs have remained the same), the compensation for such services nevertheless should be doubled to ensure the continued deployment of some arbitrary set number of

[1] *In re Request to Update Default Comp. Rate for Dial-Around Calls from Payphones*, WC Docket No. 03-225, RM Docket No. 10568, Order and Notice of Proposed Rulemaking (rel. Oct. 31, 2003) ("*NPRM*").

payphones for which there is no demonstrable need or demand. The Commission should reject such a counterintuitive conclusion.

First, there is no evidence that the current level of payphones is inadequate to meet the demand of the consuming public. Neither Section 276 nor the Commission's decisions guarantee payphone service providers (PSPs) a set level of compensation for their payphones without regard to the public's demand for such services. To the contrary, when the Commission set the rate of payphone compensation in its *Third Report & Order*,[2] it expressly acknowledged that under Section 276, the level of compensation could not be determined in a vacuum without regard to consumer demand for payphone services. *Third Report & Order* ¶ 143. Since then, as the RBOC Coalition acknowledges, *RBOC Petition* at 1, demand for payphone services has decreased given the widespread proliferation and affordability of wireless and other alternatives.

Given this undisputed decline in demand, there is simply no basis for concluding that deployment of payphones must remain fixed at some arbitrary level without regard to consumer demand. Put another way, there is no basis for concluding that a more than 100 percent increase in the dial-around compensation rate is necessary to "promote" the widespread deployment of payphones or to benefit the general public.

Even if the Commission were to conclude that the record evidence actually demonstrated that deployment was inadequate to meet consumer demand, doubling the compensation rate undoubtedly would accelerate the already existing decline in demand for payphone services. Contrary to APCC's suggestion, demand for dial-around payphone services unquestionably is price sensitive. That conclusion is confirmed by the steady migration of

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[2] *Implementation of the Pay Tel. Reclassification & Comp. Provisions of the Telecomms. Act of 1996*, Third Report & Order, And Order On Reconsideration of the Second Report & Order, 14 FCC Rcd. 2545 (1999) ("*Third Report & Order*").

payphone customers to wireless alternatives. Indeed, actual marketplace evidence confirms that consumers facing the price increases proposed by the RBOC Coalition and APCC would dramatically decrease their payphone use in favor of other alternatives. Declaration of Hans Heymann ¶¶ 15-17 ("Heymann Decl.") (Attachment A, hereto). Moreover, the inevitable decline in demand for payphone services from the consuming public would be exacerbated further by the reluctance of 1-800 subscriber customers to pay the increased cost of 1-800 calls originating from payphones. *Id.* ¶ 19-20.

Even if the Commission were to conclude that it would be appropriate to apply the same methodology adopted in the *Third Report & Order*, without regard to changes in consumer demand, the Commission should still reject Petitioners' proposals. The *Third Report & Order* adopted a per-call payment methodology that relied on the number of calls at a "marginal payphone" location and the joint and common costs associated with a marginal phone. Both APCC and the RBOC Coalition contend that they have applied that methodology with "small modifications." *RBOC Petition* at 2; *cf. APCC Petition* at 2-3, 13 n.20. But the "modifications" that they propose reflect significant and unwarranted changes both to the call-volume standards adopted by the Commission and to the determination of compensable costs.

As to call volume, both Petitioners abandon the analysis that the Commission adopted in the *Third Report & Order* and that the D.C. Circuit affirmed on appeal. Their proposed alternatives have the effect of increasing the default compensation rate by minimizing their estimates regarding the number of calls necessary to allow a payphone to recoup its costs. As to costs, even a cursory analysis of their estimates reveals that both Petitioners have sought to inflate their per payphone cost estimates. Perhaps most significant, their estimated costs associated with "equipment" ignore that payphone deployment has decreased and therefore there is a vibrant market for used payphone stations that allows efficient payphone providers to decrease equipment costs significantly. Moreover, Petitioners include costs that previously have been rejected by both the Commission and the D.C. Circuit, and which again should be rejected. *See* Part II.B., *infra.*

Finally, the unreasonableness of these proposals is confirmed by analyzing them, as did the Commission in the *Third Report & Order*, through a top-down validation based upon the unregulated market rate for payphone coin calls. *See* Part II.C., *infra.*

ARGUMENT

I. MODIFICATION OF THE DIAL-AROUND COMPENSATION RATE IS UNNECESSARY TO ENSURE WIDESPREAD DEPLOYMENT OF PAYPHONES REQUIRED TO MEET PUBLIC DEMAND.

There is no basis for modification of the dial-around payphone rate because there is no evidence that the current level of deployment of payphones is inadequate to meet consumer demand. Moreover, increasing the dial-around rate by more than 100 percent – as the RBOC Coalition and APCC propose – unquestionably would accelerate the already declining demand for payphone services.

A. Modification of the Dial-Around Compensation Rate Is Unwarranted Because There Is No Evidence That The Level of Payphone Deployment Is Inadequate To Meet Consumer Demand.

By its terms, Section 276 is designed to promote both "competition among payphone service providers" and the "widespread deployment of payphone services to the benefit of the general public." 47 U.S.C. § 276(b)(1). It requires the Commission to "establish a per call compensation plan to ensure that all payphone service providers are fairly compensated for each and every completed intrastate and interstate call using their payphone." *Id.* § 276(b)(1)(A). In the *Third Report & Order*, the Commission concluded that Section 276 required the Commission to "balance the interest of PSPs and those parties that will ultimately pay the default compensation amount" and to "ensure that the default compensation amount is sufficient to support the continued widespread availability of payphones for use by consumers." *Third Report & Order* ¶ 55. The Commission reasoned that because each "call has a relatively small marginal cost, a wide range of compensation amounts may be considered 'fair.'" *Id.* ¶ 56.

The Commission further acknowledged that "the number of calls at a marginal payphone location is affected by the compensation amount." *Id.* ¶ 142. That is, "[a]s the default amount increases, more low volume payphones become profitable; as [the] default amount decreases, more payphones become unprofitable and are likely to be taken out of service." *Id.* Given this circularity, the Commission recognized that it first must "deduce an appropriate level of payphone deployment, in order to calculate a 'fair' compensation amount." *Id.* ¶ 143. Thus, contrary to the RBOC Coalition's arguments, before the dial-around compensation rate may be modified, the Commission is obligated to consider "the appropriate level of deployment to meet market demand." RBOC Coalition Reply Comments at 10.

Indeed, that is precisely what the Commission did in the *Third Report & Order*. Based upon the record evidence, in early 1999, the Commission concluded that "the current approximate level of deployment most appropriately satisfies Congress's stated goal of promoting widespread deployment of payphones to the benefit of the general public." *Third Report & Order* ¶ 143. That conclusion was based upon "the filings of several states that have studied the payphone market in their respective jurisdictions and concluded that *the current deployment of payphones is adequately meeting the needs of the public.*" *Id.* (emphasis added). In particular, the Commission relied on the findings by state utilities commissions that had "examin[ed] the payphone market" within their respective jurisdictions and found the number of payphones to be "sufficient." *Id.* ¶ 141.

This core premise of the *Third Report & Order* – that consumer demand required preservation of 1999 levels of payphone deployment – led the Commission to build its compensation system for dial-around calls to ensure "the profitability of most existing payphones." *Id.* ¶ 143. Accordingly, the Commission established a $.24 default rate for dial-around calls by calculating the "joint and common" monthly costs for a typical payphone and dividing them by the number of calls per month placed at a "marginal [payphone] location." *Id.* ¶ 191. It defined a marginal payphone location as one where "the payphone operator is able to just recoup its costs, including earning a normal rate of return on the asset, but is unable to make payments to the location owner." *Id.* ¶ 139.

Both APCC and the RBOC Coalition recognize that the telecommunications market is significantly different today than it was at the time of the *Third Report & Order*. Given that consumer demand for payphone services has decreased, it follows that the number of payphones necessary to meet that demand also should decrease. Section 276 does not require the Commission to freeze into place policies designed to ensure the profitability of an arbitrary number of payphone regardless of changes in market conditions. To the contrary, the Commission is required to "promote the widespread deployment of payphone services" not without regard to public demand, but for "the benefit of the general public." 47 U.S.C. § 276(b)(1). If much of the "general public" already has adopted and continues to adopt alternatives to payphones, then there can be no rational basis for insisting that the current number of payphones must be maintained or that any decrease in the number of available payphones requires the Commission to increase (let alone double) the default compensation rate.

Removal of payphones from a location may be justified by a lack of consumer demand without any conceivable impact on the general public. For example, there would be no material impact on the general public if (i) in an airport or shopping mall, the number of payphones at a given location is reduced from 8 to 5 based upon a decrease in consumer demand, or, (ii) on a street corner, the number of payphones were reduced from 3 to 2 payphones where consumer demand no longer justifies the additional payphone. Section 276 cannot be interpreted to require the Commission to regulate in a manner that requires higher levels of deployment than can be justified by consumer demand.

There simply is no basis for concluding that payphone deployment is now or will be insufficient to meet declining consumer demand or that an increase in the dial-around compensation rate would result in deployment of payphones in areas where consumer needs were not already being met. *See* Heymann Decl. ¶¶ 5-11.[3]

B. The Demand For Payphone Services Is Sensitive to Price And Therefore An Increase In The Dial-Around Compensation Rate Will Further Depress Consumer Demand.

The proposals advanced by APCC and the RBOC Coalition ignore the importance of consumer demand in yet another way. If the default rate for dial-around payphone calls is increased as APCC and the RBOC Coalition propose, the cost of a payphone call will increase not only for IXCs, but also for their consumers. This price increase, in turn, will accelerate the decline in demand for payphone services. Nevertheless, "APCC and the RBOCs . . . argue that there is no reason to believe that dial-around calling is highly price-elastic." *NPRM* ¶ 28. These arguments ignore years of experience in the payphone market and should be rejected.

[3] Of course, the Commission has made clear that state commissions are free to "take action regarding payphones if they believe market forces are causing the removal of payphones in locations where they continue to be needed." *Third Report & Order* ¶ 141 n.282.

The reason for the decline in demand for payphone services is not a mystery. Heymann Decl. ¶ 13. Indeed, the Commission rightly has observed that "[p]ayphone usage and deployment are decreasing as the use of wireless services increases." *NPRM* ¶ 18. As the RBOC Coalition has acknowledged, "the number of payphone stations has decreased from prior years, due largely to wireless penetration and affordability ('wireless substitution'), and other changes in the payphone business environment." *See* "Calculation of Per-Call Compensation" at 10 ("RBOC Study") (Attachment to *RBOC Petition* (filed Sept. 4, 2002)) (emphasis added).

It stands to reason that an increase in the cost of dial-around payphone service will further speed the "'wireless substitution'" that the RBOCs properly identify as a principal cause for the decline in demand for payphone services. Heymann Decl. ¶ 14. In this regard, APCC and the RBOC Coalition both have acknowledged that (1) the public's demand for payphone service has been diminished by the pervasiveness of relatively affordable cellular technology, and (2) the cost of a coin call has increased from $0.25 or $0.35 several years ago to $0.50 per call today.[4] The decline in demand for payphone services in general cannot be separated from the rate increases of recent years and the decreases in the costs of wireless communications services.

As APCC previously informed the Commission, drops in payphone call volume can be attributed "to the drop in cellular and PCS prices." *Third Report & Order* ¶ 140.

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[4] *See RBOC Petition* at 1 (citing "extraordinary decline in the volume of payphone calls due to the proliferation of wireless telephones"); *id.*, attachment at 10 ("As expected, the number of [payphone] stations had decreased from prior years, due largely to wireless penetration and affordability"); *APCC Petition* at 1 ("market conditions have indeed changed substantially since the *Third Report and Order*"); *id.* at 7 ("The dramatic expansion of wireless services has had the effect of reducing the overall volume of calls made at payphones.").

Logically, an increase in the cost of dial-around payphone service is indistinguishable from a decrease in the cost of wireless service.[5]

AT&T's own experience confirms that demand for payphone services decreases significantly when the costs of such calls increase and when alternative means of communication are available. Heymann Decl. ¶¶ 15-17 (Attachment A). For example, data generated from payphone calls billed to AT&T calling cards showed a more than 40% decrease in number of such calls as the average per-minute price of such increased from \$0.65 to \$0.92. *Id.* ¶ 15.

Specifically, in November 1998, when the average per-minute price of a calling card call made from a payphone was \$0.65, AT&T delivered 47.58 million payphone messages billed to such cards; one year later, in November 1999, when the average per-minute price of a calling card call made from a payphone was \$0.92, AT&T delivered only 28.31 million messages. *Id.* ¶ 16. A change in the average per-minute price for a calling card call made from payphones that is comparable to the rate increase sought by the RBOC Coalition and APCC was associated with a decrease in demand of more than 40%. *Id.* ¶ 17. AT&T's data confirm that consumers who use payphones regularly remain highly sensitive to changes in price, especially when alternative services are available. *Id.*[6]

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[5] *Implementation of Section 6002(B) of the Omnibus Budget Reconciliation Act of 1993*, Seventh Report, 17 FCC Rcd. 12985, 13012 (2002) ("*Seventh Report*") (citing research showing that per-minute prices for mobile telephony in the 25 largest American cities declined 7.3 percent in 2001, following a 6.9 percent decline in 2000); *In re Implementation of Section 6002(B) of the Omnibus Budget Reconciliation Act of 1993*, Sixth Report, 16 FCC Rcd. 13350, 13377 (2001) (prices fell 25 percent in 1999); *see also Seventh Report*, 17 FCC Rcd. at 13017 (noting that three to five percent of wireless customers now use their wireless phone as their only phone); *id.* at 13012 ("there is growing evidence that consumers are substituting wireless service for traditional wireline communications").

[6] Similarly, the experience of the pre-paid phone card industry is the same. Comments of the Inter'l Prepaid Communications Ass'n, Inc. at 1-3 (filed Dec. 2, 2003). The phone card industry reports that increasing the dial-around compensation rate "will have the effect of further reducing

APCC insists, however, that, "[i]n 1999, information available to the Commission suggested that demand for dial-around services is inelastic." Declaration of Don J. Wood ¶ 7 ("Wood Reply Decl.") (Attachment to Reply Comments of APCC (filed Nov. 14, 2002)). That argument misreads the Commission's analysis. In 1999, the RBOC Coalition and APCC argued that "consumer demand for dial-around calls is less elastic than consumer demand for coin calls" and therefore would support "the price of a dial-around call higher than the price of a coin call." *Third Report & Order* ¶ 101.

The Commission rejected that proposal, noting that the data were not sufficiently reliable and were contrary to data showing that "most" consumers making coinless calls have, over time, "migrated" from making 0+ calls to more "inexpensive alternatives" such as "[c]redit card calls," "access-code calls . . . using 1-800 platforms," and now "debit card calls." *Id.* ¶ 105 n.192.[7] Indeed, the Commission expressly predicted that "the decreasing prices for cellular and PCS service, may reduce the number of payphones." *Id.* ¶ 141 n.282. Here, too, an increase in the dial-around compensation rate will decrease the demand for payphone services by causing consumers of such services to seek other alternatives for their telecommunications needs.

Second, an increase in the costs of payphone service also would affect the total number of payphone calls by suppressing the availability of 1-800 subscribers who will continue to compensate IXCs for calls delivered from payphones. As the Commission has noted, demand for payphone services increasingly now includes subscriber calls "made using 1-800 platforms."

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payphone usage" because pre-paid card users employ cards to take advantage of "the least-cost alternative" for long-distance usage. *Id.* at 3.

[7] To be sure, the Commission recognized that some subset of consumers continued to make 0+ calls and thus were, by definition, less elastic than others. *Third Report* & Order ¶ 105 n.192.

Id. ¶ 105 n.192. With regard to such calls, the payphone customer makes no payment to complete a payphone call. Rather, subscribers to the 800 service compensate the IXCs for completing calls to a designated 1-800 number. Many such subscribers, however, are sensitive to the per-call costs that they are required to pay to allow their customers to complete such calls. Heymann Decl. ¶ 20 (Attachment A). As a result, there is a very real risk that any increase in the per-call compensation rate will cause subscribers to 800 service to require IXCs such as AT&T to block calls generated from payphones, and thereby further decrease payphone call volume. *Id.*

* * * *

Section 276 and the *Third Report & Order* require the Commission to consider consumer demand when addressing the proper level of compensation for dial-around payphone calls. The Commission is not permitted to adopt an approach that ignores whether the current deployment of payphones is adequate to meet consumer demand.

II. THE COMMISSION SHOULD REJECT THE PROPOSALS BY THE RBOC COALITION AND APCC BECAUSE THEY ARE BASED UPON IMPROPER ANALYSES AND UNRELIABLE DATA.

Although Petitioners purport to adhere to the "marginal" payphone methodology from the Commission's *Third Report & Order*, their analyses depart in significant ways from the core of the Commission's prior analysis. Essential to the Commission's prior approach is the "marginal payphone location," which the Commission defined as "a location where the payphone operator is able to recoup just its costs, including earning a normal rate of return on the asset, but is unable to make payments to the location owner." *Third Report & Order* ¶ 139. Petitioners acknowledge, and then ignore, the manner in which the Commission determined the volume of payphone calls at a marginal payphone location in the *Third Report & Order*. Similarly, Petitioners' cost analyses depart significantly from the approach reflected in the *Third*

Report & Order. As a result, it comes as no surprise that the bottom-up default rates proposed by Petitioners cannot be justified when compared, as the Commission did in the *Third Report & Order*, to the default compensation rate that would be generated by a top-down methodology.

A. The Call Volume Estimates Proposed By APCC And The RBOC Coalition Are Not Based Upon The Methodology Reflected In The *Third Report & Order.*

In the *Third Report & Order*, the Commission determined the call volume at a "marginal payphone location" by taking the midpoint between "the number of payphone calls that must be placed in order for the premises owner to not have to pay the LEC PSP for the payphone" and "the number of payphone calls that must be placed in order for the LEC PSP to begin paying a location payment to the premises owner." *Id.* ¶ 147. Using this approach, the Commission endeavored to estimate the call volume at a payphone that "generates sufficient revenue to pay for itself." *Id.* ¶ 146. That analysis was affirmed on appeal. *APCC* v. *FCC*, 215 F.3d 51, 57-58 (D.C. Cir. 2000) (explaining that a marginal payphone is one "that breaks even"). As demonstrated below, the "marginal" payphone call volumes provided by Petitioners cannot be reconciled with the Commission's approach.

1. APCC's Call Volume Estimates Are Based Upon A Survey That Is Fundamentally Flawed And Should Be Rejected.

APCC's call volume data is fundamentally flawed and cannot be reconciled with the *Third Report & Order*. APCC filings have done nothing to undermine that conclusion.

APCC tentatively asserts that payphone call volumes at marginal payphones have fallen "by nearly half, to 234 from . . . 439." *APCC Petition* at 13. That determination is based upon a cost study generated through a survey that asks a "series of questions concerning whether any commissions are currently paid by the independent PSP to the location owner." *Id.* at 12. As APCC explains, it identified a set of "marginal payphones," which APCC defined as "those for which no commissions are paid to the location owner." *Id.* In doing so, APCC recognizes the importance of reflecting the "actual . . . calls made from marginal payphones, as required under the Commission's *Third Report & Order* methodology." *Id.* APCC's approach is fundamentally flawed.

First, as discussed above, the Commission defines a marginal payphone location as "a location where the payphone operator is able to just recoup its costs, including earning a normal rate of return on the asset, but is unable to make payments to the location owner." *Third Report & Order* ¶ 139. Accordingly, there are *two* criteria that make a payphone at a given location a "marginal" payphone: (1) the payphone owner is "unable to make payments to the location owner," *and* (2) "the payphone operator is able to just recoup its costs, including earning a normal rate of return on the asset." *Id.* The second criterion is essential because the Commission made clear that its approach was "not designed to make every payphone profitable." *Id.* ¶ 79. As the Commission explained, "[p]ayphones with sufficiently low call volumes or sufficiently high costs will not be profitable, regardless of the compensation amount we establish." *Id.*

APCC's proposal, however, is based upon a survey that defines "marginal payphones" solely as "those for which no commissions are paid to the location owner."[8] Although the absence of commissions from the payphone owner to the premises owner is a *necessary* element of identifying a marginal payphone location, that factor is not by itself sufficient because it fails to confirm that the payphone is one that allows the payphone owner to

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[8] *APCC Petition* at 12; *see also* "Per Call Cost Study for Dial-Around Calls" at 5 (Attachment 1 to *APCC Petition*) ("Results are reported for these 'marginal payphones' (the average per-payphone costs and average number of calls at payphones for which no commissions are paid to the premises owner).").

"recoup its costs, including earning a normal rate of return," *id.* ¶ 139, or, as the D.C. Circuit explained, "a payphone that breaks even," *APCC* v. *FCC*, 215 F.3d at 57. As explained by Dr. Robert M. Bell, APCC's study has skewed its results by failing to eliminate from its survey sample payphones that do not allow the owner to "recoup its costs, including earning a normal rate of return." *Third Report & Order* ¶ 139; see Declaration of Dr. Robert M. Bell ¶ 11 ("Bell Decl.") (Attachment A to Comments of AT&T (filed Oct. 30, 2002) (Attachment B, hereto).

APCC argues that these criticisms are unwarranted because "APCC's cost study methodology excluded payphones for which the premises owner makes a payment to the PSP, as well as payphones for which the PSP pays the premises owner a commission." APCC Reply Comments at 17 (citing Wood Reply Decl. ¶ 14). That argument misses the point. Even if one could ignore the definition of marginal phones used in APCC's survey and thus *assume* that payphones for which the premises owner paid a commission actually were excluded, APCC's survey plainly does not exclude payphones which do not "recoup [their] costs, including earning a normal rate of return." *Third Report & Order* ¶ 139. Put another way, APCC's survey is invalid because it makes no effort to exclude the unprofitable payphones with "sufficiently low call volumes or sufficiently high costs" that "will not be profitable, regardless of the compensation amount [the Commission] establish[es]." *Id.* ¶ 79; *see also* Bell Decl. ¶¶ 11-12.[9]

Indeed, the Commission, in the *Third Report & Order*, was careful to account for this problem by determining the average number of payphone calls at a marginal location as the

[9] Despite its protestations, APCC's survey simply does not make clear that it excludes semi-public payphones for which the payphone owner receives a rent from the premises owner. Bell Decl. ¶ 11. Although its survey questionnaire includes one question that asks whether the payphone owner "*receive[s]* any compensation *from* the location provider to maintain or service this ANI," *APCC Petition*, Attachment at D5.3, the APCC study never states that a positive answer on this question would exclude a payphone from its analysis, Bell Decl. ¶ 11.

midpoint between the "the number of payphone calls that must be placed in order for the premises owner to not have to pay the LEC PSP for the payphone" and "the number of payphone calls that must be placed in order for the LEC PSP to begin paying a location payment to the premises owner." *Third Report & Order* ¶ 147. As a result, APCC's survey does not accurately reflect the call volumes associated with marginal payphone locations as contemplated by the *Third Report & Order*. Bell Decl. ¶ 12 (Attachment B, hereto).

The survey's failure to exclude unprofitable low-volume phones results in a call count at APCC's "marginal" payphone that is lower than it would be if calculated correctly. *Id.* ¶ 11. For example, as explained by Dr. Bell, assume that 50 percent (54 of the 108) of the payphones classified as marginal were classified correctly, while 50 percent (the other 54) failed to recoup costs, so that they were not truly marginal. *Id.* ¶ 12. In addition, assume that the average number of calls per month for the former group was 400 and for the latter group was 68. *Id.* In this hypothetical, the average number of calls across all 108 payphones would be 234 (the same as in the APCC study). *Id.* However, the correct average, that for the 54 truly marginal payphones, would be 400, an even higher number than that found by the Commission in the *Third Report & Order*. *Id.*[10]

Second, even if APCC's survey were valid and reliable – and it is not – its call volumes are understated by an unknown amount because APCC admits (in a footnote dealing with marginal payphone costs) that APCC did not include all completed calls in determining the

[10] Dr. Bell has identified other significant errors in the APCC study. First, the APCC Study provides no indications about the size of sampling variability among its geographically stratified sub-samples. Bell Decl. ¶ 15. There is therefore no means of determining how far off the estimated average sample size might be. *Id.* Second, as Dr. Bell explains, the response rate to APCC's survey was less than 50 percent (408 of 940). This high non-response rate may have biased the results of the survey, since certain types of payphone operators might have been more likely to respond than others. *Id.* ¶¶ 13-14.

call volumes at a "marginal payphone." *APCC Petition* at 13 n.20. Rather, APCC reduced its call volume numbers by "utilizing only *paid* dial-around calls in determining the call volumes generated at a marginal payphone." *Id.* APCC purports to justify this reduction in call volume as a way to address the problem of "bad debt." *Id.* That approach is indefensible.

In the *Third Report & Order*, the Commission calculated marginal payphone call volumes by examining the total number of such completed calls at a "marginal" payphone. *Third Report & Order* ¶ 146. The Commission did not reduce this volume to adjust for the number of calls for which payphone providers argued that they had not been paid. *Id.* To the contrary, the Commission rejected efforts to include claims of "bad debt" in its analysis because, among other things, "PSPs that ultimately recover their uncollectibles from delinquent carriers would then double-recover: once from the debtor and once from the consumer, *i.e.*, through the cost element included in the compensation amount." *Id.* ¶ 162. That conclusion was affirmed on appeal. *APCC* v. *FCC*, 215 F.3d at 55-56.

In light of these decisions, APCC's improper efforts to inject its bad debt estimates into its volume analysis without any acknowledgement or explanation that "bad debt" has been deemed irrelevant underscores the lack of credibility of APCC's entire methodology.

2. *The RBOC Coalition's Call Volume Estimates Ignore the Methodology Adopted in The* Third Report & Order*.*

The RBOC Coalition's estimates of payphone call volumes are similarly flawed. In its Petition, the RBOC Coalition argues that the Commission should "continue to calculate the dial-around rate by calculating the call volume at the 'marginal payphone location,'" but then contends that the Commission's methodology for determining the volume of calls at a marginal payphone should not be used here. *RBOC Petition* at 5. The Coalition does not contend that data of the type previously provided to the Commission are no longer available. Nor can the

Coalition dispute that the D.C. Circuit affirmed the approach that the Commission adopted to calculate the marginal payphone volume. *APCC* v. *FCC*, 215 F.3d at 57-58. Instead, the Coalition proposes a methodology that departs fundamentally from the *Third Report & Order*.

Specifically, the Coalition's methodology uses not only call volumes at marginal payphone locations, but also call volumes for (i) payphones for which the premises owner pays a rent, and (ii) payphones for which the premises owner collects a rent. *RBOC Petition* at 5. In the *Third Report & Order*, however, the Commission ruled that the volume of calls at a marginal payphone location should *exclude* call volumes for locations where premises owners pay or receive rents and should instead reflect only the call volume at "a location where the payphone operator is able to just recoup its costs." *Third Report & Order* ¶ 139. Further, the RBOC Coalition, like APCC, makes no effort to exclude from its estimates payphones that currently do not "recoup [their] costs." *Id.* As noted previously, inclusion of such payphones results in a call volume that is lower than it would be if calculated under the Commission's existing standards. As a result, the RBOC Coalition's approach violates central tenets of approach adopted in the *Third Report & Order*.[11]

The RBOC Coalition does not pretend that its analysis can be reconciled with the *Third Report & Order*. Instead, it argues that its substitute approach "is the same methodology that the Commission itself used in the *Second Report & Order*" and that its current approach

[11] Further, the Coalition's efforts to adjust its calculation for its inclusion of payphones that earn a rent from premises owners and payphones for which premises owners demand locational rents further exacerbates its error. Specifically, the Coalition treats the payments that it makes to premises owners as a cost that is recovered by calls over-and-above the marginal payphone volume. But the Commission has concluded that "locational rents should be treated as a form of profit rather than a cost." *Third Report & Order* ¶ 37 n.72.

"reflects the market analysis that the Commission applied in the *Third Report and Order* as well." RBOC Reply Comments at 11. These arguments should be rejected.

As noted, the Commission's market analysis in the *Third Report & Order* was predicated on identifying call volume at a "marginal payphone location," *i.e.*, "a location where the payphone operator is able to just recoup its costs, including earning a normal rate of return on the asset, but is unable to make payments to the location owner." *Third Report & Order* ¶ 139. To implement that central tenant, the Commission was not satisfied with the submissions by the RBOCs in connection with the *Second Report & Order*. *Id.* ¶ 145.[12] Instead, the Commission required the RBOCs to submit:

> (1) the number of payphone calls that must be placed in order for the premises owner to not have to pay the LEC PSP for the payphone; and (2) the number of payphone calls that must be placed in order for the LEC PSP to begin paying a location payment to the premises owner.

Id. ¶ 147. Thereafter, the Commission adopted the midpoint between both estimates as the appropriate call volume for a marginal payphone location. *Id.* In doing so, the Commission made clear that its "approach is not designed to make every payphone profitable." *Id.* ¶ 79.

Here, however, the RBOC Coalition has skewed the analysis by including in its analysis payphones that are not "marginal" because they do not recover their costs and a normal rate of return. *See id.* ¶ 139. Simply put, the Coalition cannot argue that the Commission should adhere to the "marginal" payphone approach adopted in the *Third Report & Order*, but then propose a methodology for determining "marginal" payphone calling volume that undermines it.

[12] That is not surprising, given that the Commission's approach adopted in the *Second Report & Order* had been rejected in significant respects on appeal by the D.C. Circuit. *See MCI Telecomms. Corp.* v. *FCC*, 143 F.3d 606, 608 (D.C. Cir. 1998).

B. APCC And The RBOC Coalition's Joint and Common Payphone Costs Are Inflated and Based Upon An Analysis That Is Inconsistent With The Commission's Prior Orders.

In the *Third Report & Order*, the Commission adopted a bottom-up approach to determining joint and common payphone costs for the purposes of calculating default payphone compensation. *Third Report & Order* ¶ 72. Petitioners purport "to duplicate as closely as possible the requirements and mechanisms set forth in the *Third Report and Order*." *RBOC Petition* at 6; *APCC Petition* at 2 ("APCC does not propose any major departure from the cost model that the Commission developed in the *Third Report & Order*"). An examination of the Petitions, however, reflects that they are inflated and that they depart in significant ways from the analysis that the Commission has employed in the *Third Report & Order*. *See NPRM* ¶ 26 (seeking comment on cost studies).[13]

1. The Cost Estimates Are Inflated And Ignore Changes In The Market For Payphone Services.

Perhaps the greatest overstatement of costs by APCC and the RBOC Coalition is with regard to equipment costs. For example, the RBOC Study provides that payphone equipment costs had not changed significantly from the amounts detailed in the Commission's *Third Report and Order*. RBOC Study at 3. That assumption ignores that consumer demand, and with it the number of payphones in the market, has declined in recent years. Thus, the current cost of equipment is no longer cost of "new" equipment, but rather the actual cost of the used or recycled equipment that has been eliminated from service and is sitting idle in warehouses. Heymann Decl. ¶ 23 (attachment A).

[13] Because APCC's cost estimates were generated using the same flawed study used to generate their call volume figures, APCC's cost figures should be rejected as inherently unreliable.

Indeed, the RBOCs acknowledge that payphone deployment has "'fallen by . . . more than 20%'" since 1998 when the data underlying the *Third Report & Order* was collected. *Id.* ¶ 24. Accordingly, the equipment costs identified are plainly excessive given that PSPs need not and do not purchase "new" equipment, but instead use their own warehoused equipment or other used equipment for new payphone installations or replacement of existing equipment. *Id.* These realities are nowhere reflected in the estimate of equipment costs identified by the RBOC Study or by the APCC Study.

AT&T estimates that the equipment costs associated with the 12,000 payphone units that it deploys in military bases are significantly lower than the equipment costs identified by the RBOCs and APCC. *Id.* ¶ 25 (Attachment A). With regard to these payphones, AT&T typically does not purchase "new" equipment, but instead uses its own warehoused equipment for new installations. *Id.* AT&T and other IXCs should not be required to subsidize real or apparent inefficiencies associated with the RBOC and APCC members' equipment costs.[14]

2. *Inclusion of a Cost Component For Bad Debt Is Inconsistent With The* Third Report & Order.

The RBOC Coalition contends that "bad debt" should be included in payphone costs. *RBOC Petition* at 10 (arguing that "bad debt" results in "a cost of $0.028 per call"). The Coalition acknowledges that "[t]he Commission declined to include bad debt in its cost calculations" but argues that "PSPs have collected much more reliable data relating to bad debt"

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[14] Further, to the extent that payphone providers have been compensated for almost seven years for capital costs associated with phones that they have in service, these capital costs should be reduced significantly because these phones, by now, have been almost fully depreciated. As a result, the capital costs associated with new payphones, if Petitioners' description of market changes were accepted, should be substantially decreased.

and therefore "bad debt" should now be included as a compensable cost. *Id.* This argument should be rejected.

First, although the Commission's previous rejection of efforts to "include bad debt in its cost calculation" was based in part on "insufficient information," that was not the only or even the principal reason that the Commission rejected this cost component. The Commission explained that (i) "the recent history of per-call compensation payments is not an accurate guide for future levels of bad debt," (ii) it did "not know the percentage of uncollected per-call compensation that is due to billing errors of the PSPs, as opposed to unscrupulous carriers," and (iii) "PSPs that ultimately recover their uncollectibles from delinquent carriers would then double-recover." *Third Report & Order* ¶ 162. This analysis, in turn, was affirmed on appeal. *APCC* v. *FCC*, 215 F.3d at 56 (affirming Commission's to refusal to include bad debt element where "[t]he plight of the allegedly uncompensated payphone service provider does not equate to that of a merchant pursuing deadbeat customers in the marketplace").

The Coalition's claim that PSPs "have collected much more reliable data," *RBOC Petition* at 10, does not even purport to address the Commission's concerns regarding "double recovery" or whether the bad debt is attributable "to billing errors of the PSPs." Moreover, even if PSPs have more accurate historical data relating to bad debt, there has been no showing that these historical data are "an accurate guide for future levels of bad debt," *Third Report & Order*, ¶ 162, especially where, as the D.C. Circuit has explained, "the factors affecting that data may change in the future," 215 F.3d at 56.

In this regard, reliance upon past experience would be particularly improper because the Commission recently acted to address concerns raised by PSPs with regard to the non-payment of bills by adopting new procedures to ensure that PSPs were paid for all completed calls.[15] In the recent *SBR Order*, the Commission explained that the new rules would "resolve two princip[al] concerns: (1) the inability of PSP to obtain information about the identity of the [switch-based reseller], and the number of completed calls; and (2) the incentive of the [switch-based reseller] to avoid detection and paying the PSP." *Id.* ¶ 54. Given these recent regulatory developments, it plainly would be inappropriate to rely upon past practice as an accurate predictor of future "bad debt."

Second, the RBOC Coalition's "bad debt" estimates should be excluded because inclusion of that cost component, in effect, would require some IXCs to pay the debts of other IXCs. But the Commission has ruled that Section 276, as construed by the D.C. Circuit, does not permit the Commission to "require one company to bear another one's expenses."[16] In doing so, the Commission rejected efforts to "shift the burden of paying outstanding . . . per-phone compensation to IXCs that paid," concluding that such an approach would be "unfair and inequitable and would violate the principle established in the *Illinois* case." *Fifth Order* ¶ 83. Indeed, the Commission more recently reconfirmed that "section 276 does not permit" "certain companies to pay compensation owed by other delinquent companies." *SBR Order* ¶ 31.

3. *A Cost Component For Collection Costs Is Inconsistent With The* Third Report & Order.

Both the RBOC Coalition and APCC seek to recover "collection costs," even though the Commission rejected these arguments in the *Third Report & Order*. APCC admits that the Commission has rejected this argument, but contends that "more than adequate

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[15] *See The Pay Tel. Reclassification & Comp. Provisions of the Telecomms. Act of 1996*, CC Docket No. 96-128, Report & Order, ¶¶ 51-54 (rel. Oct. 3, 2003) ("*SBR Order*").

[16] *Implementation of the Pay Tel. Reclassification & Comp. Provisions of the Telecomms. Act of 1996*, CC Docket No. 96-128, Fifth Order on Reconsideration & Order on Remand, ¶ 82 (rel. Oct. 23, 2002) ("*Fifth Order*").

information is available." *APCC Petition* at 13. APCC's argument misconstrues the Commission's prior analysis.

Previously, the Commission concluded that "the collection costs of dial around compensation are fairly represented by the [Sales, General, and Administrative Costs (SG&A) costs] portion of joint and common costs." *APCC* v. *FCC*, 215 F.3d at 57. The Commission reasoned that there was "insufficient information on the record to determine the extent to which administrative costs vary when the number of coinless calls increases relative to coin calls." *Third Report & Order* ¶ 164. Here, neither APCC nor the RBOC Coalition provide sufficient information to undermine the conclusion that collection costs already are fairly represented by the SG&A portion of joint and common costs or to allow a determination of the "variance of administrative costs which occur from a rise coinless calls relative to coin calls." 215 F.3d at 57. As a result, Petitioners' efforts to recover "collection costs" should be rejected.

Further, adoption of an additional "collection costs" component should be rejected because, as with "bad debt," the Commission recently has adopted measures to address concerns regarding the collection of debt by PSPs. *See SBR Order* ¶¶ 51-54. These new measures are designed expressly to "enable a PSP to identify SBRs that are not compensating it and to challenge the payments in instances where the PSP may believe that the data provided by other facilities-based long distance carriers is out of proportion to the data provided by the final SBR in the call path." *Id.* ¶ 52.

C. Application of A Top-Down Methodology Confirms That Petitioners' Proposed Rate Increases Are Unsupportable.

Previously, the Commission performed a top-down calculation to validate that the bottom-up methodology that it employed in the *Third Report & Order* yielded a reasonable result. *Third Report & Order* ¶ 192. APCC argues that the Commission did not purport to "validate" its bottom-up analysis in the *Third Report & Order* with a "top-down approach." Wood Reply Decl. ¶ 8 ("a careful reading of the *Third Report and Order* indicates that 'validate' is much too strong a word"). That is wrong. The Commission plainly stated that it "performed a top-down calculation *to validate* that our bottom-up methodology is reasonable." *Third Report & Order* ¶ 192 (emphasis added). Application of that same analysis here makes clear that Petitioners' proposals are grossly excessive and will result in a windfall to payphone providers that must be borne by IXCs and the ever decreasing pool of payphone customers.

In the *Third Report & Order*, the Commission sought to validate the per-call compensation rate that the Commission derived from its bottom-up marginal cost and call volume calculations by comparing that rate to the rate derived using a top-down methodology. Using what commenters agreed was the "predominant local coin calling price in the United States," (*i.e.*, $0.35 per call), and then subtracting "the cost of the coin mechanism, termination charges, and coin collection charges," the Commission concluded that using a top-down approach, the default per-call rate would be $0.23 per call, or "within a penny of the default amount arrived at under our bottom-up approach." *Id.* ¶¶ 192, 193. The Commission explained that its top-down calculation was relevant because it "supports the reasonableness of the default compensation amount [the Commission] adopt[ed]" in the *Third Report & Order*. *Id.* ¶ 192.

Application of this same analysis here demonstrates that Petitioners' proposed rate increases are wildly exaggerated and unreasonable. In particular, assuming that the RBOC Coalition were correct that the "unregulated" market price for a local coin call "has risen to $.50" per call, *RBOC Petition* at 1-2, then the per-call compensation rate of $0.49 and $0.48 per call for coinless calls is unsupportable. Petitioners contend that their common costs have remained largely static, and they provide no basis for concluding that their costs for coinless calls have changed since the *Third Report & Order*. Further, according to Petitioners, the call volume at a marginal payphone location has decreased, thereby increasing the per-call costs of coin payphone calls.

Using the RBOC Coalition's own call volume figures, and assuming—as the RBOCs do, RBOC Reply Comments at 9 n.6—that the percentage of coin calls has not changed significantly since 1998, and using average (rather than marginal) payphone call volumes, the cost of the installation of a coin mechanism would be \$0.109 per call.[17] Similarly, the local termination charges would be \$0.038 per call. *Third Report & Order* ¶ 193. Finally, the collection charges would be \$0.074 per call.[18] Taken together, and subtracted from the unregulated market rate of \$0.50 per call, a top-down approach yields a per call rate for coinless calls of \$0.279.[19] Furthermore, as the Commission recognized in the *Third Report & Order*, if a marginal call rate were used, the default compensation rate "would be even lower." *Id.* ¶ 193 n.405. Indeed, using the RBOC Coalition's own estimated marginal payphone call volume estimates (219 calls per month), the top-down methodology yields a default rate for a coinless call of \$0.25 per completed call.[20]

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[17] The cost of installing a coin mechanism is \$17.02 per month. *Third Report & Order* ¶ 193. The number of coin calls is the average number of total calls (253) times the percentage of calls that are coin calls (61.5%, *see Third Report & Order* ¶ 193 n.405), or 156 coin calls per month. The per coin-call cost of a coin mechanism is thus \$17.02/156, or \$0.109 per call.

[18] Coin collection charges were \$11.59 per month. Thus, coin collection costs, divided by the 156 coin calls at an average payphone, amount to \$0.074 per coin call.

[19] \$0.50 (unregulated coin call charge) - \$0.109 (per call cost of coin mechanism) - \$0.038 (local termination charge) - \$0.074 (per call coin collection cost) = \$0.279 per coinless call.

[20] Specifically, according to the RBOC Coalition, the number of coinless calls per month at a marginal phone would be (219) multiplied by the percentage of calls that are coin calls (61.5 %) or 134.7 calls coin calls per month. *See Third Report & Order* ¶ 193 n.405. As a result, the per call costs of the coin mechanism and coin collection would increase to \$0.126 and \$0.086 per coin call. The per call local termination costs would remain the same (\$0.38 per call).

CONCLUSION

For these reasons, the Commission should decline to modify the compensation for dial-around payphone calls. In all events, the Commission should reject the proposed modifications to the current default rate proposed by APCC and the RBOC Coalition because they are based upon fundamentally flawed analyses and data.

Respectfully submitted,

/s/ Lawrence J. Lafaro

Lawrence J. Lafaro
Stephen C. Garavito
Martha Lewis Marcus
AT&T CORP.
Room 3A225
One AT&T Way
Bedminster, New Jersey 07921
Tel. (908) 532-1841

Paul J. Zidlicky
Joseph R. Palmore
SIDLEY AUSTIN BROWN & WOOD LLP
1501 K Street, N.W.
Washington, D.C. 20005
Tel. (202) 736-8000

Counsel for AT&T Corp.

Dated: January 7, 2004

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing Comments of AT&T Corp. was served, by the noted methods, the 7th day of January, 2002, on the following:

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Room TW-A-325
Washington, D.C. 20554
By Electronic Filing

Qualex
Portals II
Federal Communications Commission
445 12th Street, S.W.
Room CY-B402
Washington, D.C. 20554
By E-Mail

RBOC Payphone Coalition
Michael Kellogg
Aaron M. Panner
Kellog, Huber, Hansen, Todd & Evans, P.L.L.C.
1615 M Street, N.W., Suite 400
Washington, D.C. 20036
By Hand

American Public Communications Council
Albert H. Kramer
Robert F. Aldrich
Jacob S. Farber
Dickstein Shapiro Morin & Oshinsky LLP
2101 L Street, N.W.
Washington, D.C. 20037
By Hand

/s/ Peter Andros
Peter Andros

Attachment A

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	WC Docket No. 03-225
Request to Update Default Compensation Rate for Dial-Around Calls from Payphones	)	RM No. 10568

DECLARATION OF HANS HEYMANN

I. QUALIFICATIONS.

1. My name is Hans Heymann. I am the District Manager in AT&T's Local Network Services Division supporting the National Public Markets business unit.

2. I received a Master Degree in Business Administration from Rutgers University. Prior to that, I graduated from Boston University with a Bachelor's Degree in Philosophy and Psychology.

3. For the past 20 years, I have been intimately involved with the public communications business. During that time, my responsibilities and much of my focus have been in a product management and marketing role relating to payphone hardware and, subsequently, in the payphone service business. I have managed the operations for various AT&T public communications products and services. In doing so, I have studied and analyzed production costs, operational methods and their associated costs, and other aspects of the public communications business. I have dealt on a daily basis with the overall cost structure of the

payphone market from the perspective of producing payphone equipment as well as payphone operations.

4. I have managed the payphone platforms for large contracts and large national chain accounts that are served by AT&T. Support of these accounts encompasses hundreds of locations and tens of thousands of payphone stations. In managing these payphone assets, I have observed first-hand the changes that have occurred in the payphone industry in the past few years, including modulations in payphone usage as well as changes in the costs of providing payphone service.

II. DEMAND FOR PAYPHONE SERVICES HAS DIMINISHED IN LIGHT OF RELATIVELY AFFORDABILE ALTERNATIVE TECHNOLOGIES.

5. In recent years, the public's demand for payphone services has diminished significantly. That decrease is the result of increased popularity and relative affordability of wireless technology that has provided an ample and effective substitute for payphone services. Where individuals previously might depend on the availability of payphones while traveling through venues such as airports and train stations, that demand now is being met by other technologies including cellular phones and other wireless technologies.

6. I understand that the Commission made a determination in the *Third Report & Order* to establish a per-call compensation scheme that would "balance the interest of PSPs and those parties that will ultimately pay the default compensation amount," and "ensure that the default compensation amount is sufficient to support the continued widespread availability of payphones for use by consumers." *Third Report & Order* ¶ 55.[1]

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[1] *In re Implementation of the Pay Telephone Reclassification and Compensation Provisions of*

7. To address these competing concerns, the Commission adopted a marginal payphone methodology. Critical to that methodology was a determination of "an appropriate level of payphone deployment, in order to calculate a 'fair' compensation amount." *Id.* ¶ 143. The Commission concluded in January 1999, that the then "current approximate level of deployment most appropriately satisfies Congress's stated goal of promoting widespread deployment of payphones to the benefit of the general public" and based that determination on filings of "several states that have studied the payphone markets in their respective jurisdictions and concluded that the *current deployment of payphones is adequately meeting the needs of the public*." *Id.* (emphasis added).

8. Here, it is undisputed that there is a significantly lesser need on the part of the public for payphone services than there was back in 1999 when the Commission concluded that the deployment of payphones at that time was appropriate to "meet[] the needs of the public." *Id.* As the RBOC Coalition acknowledges, "the number of payphone stations has decreased from prior years, due largely to wireless penetration and affordability ('wireless substitution'), and other changes in the payphone business environment." RBOC Study at 10 (Attachment to RBOC Petition).

9. Despite this decrease in demand for payphone services, reductions in the deployment of payphones have not tracked the decline in demand. The reason that payphone deployment has not fallen proportionally with the decreases in demand for payphone services is that currently deployed payphones are providing a net benefit to the RBOCs and independent PSPs.

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the Telecommunications Act of 1996, Third Report & Order, And Order On Reconsideration of the Second Report & Order, 14 FCC Rcd. 2545 (1999) ("*Third Report & Order*").

10. That conclusion follows from the Commission's own analysis of the payphone marketplace. As the Commission has explained, "absent regulations that require payphone owners to place phones in locations where they will lose money, *we should not expect to see money-losing payphones* that offset the profits earned on profitable payphones." *Third Report & Order* ¶ 39 (emphasis added). That conclusion reflects the Commission's long-standing view that "the payphone market has low entry and exit barriers." *NPRM* ¶ 5 (citing *First Report & Order*).[2] Indeed, the Commission has set the compensation rate knowing full well that where compensation is inadequate, unprofitable payphones would "exit the industry." *Third Report & Order* ¶ 141. Conversely, the Commission recognized that "even if the compensation amount were set at zero, many payphones would earn a profit." *Id.* ¶ 39. There is no reason to expect that the vast majority of payphones currently deployed by the RBOCs and independent PSPs are unprofitable.

11. Accordingly, the effect of an increase in the per call compensation rate would (1) "reduce the break-even number of calls" and (2) assuming that demand remained constant, "increase the number of payphones." *Id.* There simply is no basis for an increase in per call compensation because there is no convincing evidence that (1) the current level of payphone deployment is inadequate, or (2) that an increase in the per call compensation rate would result in the deployment of payphones in locations where consumer demand is not already being met. Absent such a showing, an increase in compensation would serve only to increase the per call revenues from already profitable payphones currently in service. *See id.*

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[2] *In re Request to Update Default Compensation Rate for Dial-Around Calls from Payphones*, WC Docket No. 03-225, RM Docket No. 10568, Order and Notice of Proposed Rulemaking (rel. Oct. 31, 2003) ("*NPRM*").

III. AN INCREASE IN THE PER CALL COMPENSATION FOR DIAL-AROUND CALLS WILL SPEED THE DECLINE IN DEMAND FOR PAYPHONE SERVICES.

12. There is ample reason to conclude that increases in the per call rate associated with coinless payphone calls would further speed the decline in demand for payphone services.

13. The reason for the decline in demand for payphone services is not a mystery. "Payphone usage and deployment are decreasing as the use of wireless services increases." *NPRM* ¶ 18.

14. Ironically, APCC and the RBOCs seek to address this migration from payphone service to wireless service by doubling the per-call compensation rate for dial-around calls. But such an increase in the cost of payphone service will further speed the "wireless substitution" that the RBOCs rightly identify as the cause for the decline in demand for their payphone services. RBOC Petition at 1.

15. AT&T's experience is that the demand for payphone services decreases significantly when the costs of such calls increase and when alternative means of communication are available. During the period from November 1998 to November 1999, data generated from payphone calls that were billed to AT&T calling cards showed a 40% decrease in the number of such calls as the average per-minute price of these calls increased from $0.65 to approximately $0.92.

16. Specifically, in November 1998, when the average per-minute price of an AT&T calling card call made from a payphone was $0.65, AT&T delivered 47.58 million payphone messages billed to such cards. In November 1999, when the average per-minute price

of a calling card call from a payphone was $0.92, AT&T delivered only 28.31 million messages billed to such cards.

17. Taken together, a change in the average per-minute price for a calling card call made from a payphone that is less dramatic than the rate increase sought by the RBOC Coalition and APCC was associated with a more than 40% decrease in demand. These data confirm that consumers remain highly cost sensitive in their demand for public telecommunications services, especially when alternative sources of service are available.

18. APCC, for its part, suggests that, "[i]n 1999, information available to the Commission suggested that demand for dial-around services is inelastic." Reply Declaration of Don Wood ¶ 7 (Attachment to Reply Comments of APCC (filed Nov. 14, 2002)). That conclusion is contrary to AT&T's real-world data, which show that dial-around customers are highly price sensitive.

19. Further, an increase in the costs of payphone service also would effect the total number of payphone calls by suppressing the availability of 1-800 subscribers who will continue to compensate IXCs for calls delivered from payphones. As the Commission has noted, demand for payphone services increasingly now includes subscriber calls "made using 1-800 platforms." *Third Report & Order* ¶ 105 n.192. With regard to such calls, the payphone customer makes no payment to complete a payphone call. Rather, subscribers to 800 service compensate the IXCs for completing calls to a designated 1-800 number.

20. Many such subscribers, however, are sensitive to the per-call costs of completing such calls. As a result, there is a very real risk that any increase in the per-call compensation rate will cause subscribers to 800 service to require AT&T to block calls generated

from payphones. The result of this call blocking will decrease the volume of payphone calls further.

IV. ANALYSIS OF COST STUDIES FOR DIAL-AROUND CALLS SUBMITTED BY THE AMERICAN PUBLIC COMMUNICATIONS COUNCIL ("APCC") AND RBOC COALITION.

21. I have reviewed the "Calculation of Per-Call Compensation" (RBOC Study), submitted by RBOC Payphone Coalition with its Petition for Rulemaking to Establish Revised Per-Call Payphone Compensation Rate. I also have reviewed the "Per-Call Cost Study for Dial-Around Calls" (APCC Study), submitted by APCC in connection with its Request that the Commission Issue a Notice of Proposed Rulemaking (Or in the Alternative, Petition for Rulemaking) to Update Dial-Around Compensation Rate (APCC Request).

22. Based upon my review of the RBOC Study and the APCC Study, I have concluded that the costs identified are significantly overstated. Indeed, many of the costs identified are significantly greater than the costs that AT&T has experienced in connection with its own payphone operation.

23. Perhaps the greatest overstatement of costs is contained in the equipment costs claimed by the RBOC Study and the APCC Study. The RBOC Study provides that payphone equipment costs had not changed significantly from the amounts detailed in the Commission's *Third Report and Order*. RBOC Study at 3. That assumption ignores the undisputed fact that the number of payphones in the market has declined in recent years. Thus, the current cost of equipment is no longer the cost of "new" equipment, but rather the actual cost of the used or recycled equipment that has been eliminated from service and is sitting idle in warehouses.

24. Indeed, the RBOCs acknowledge that payphone deployment has "fallen by . . . more than 20%" since 1998 when the data underlying the *Third Report & Order* was collected. Accordingly, the equipment costs identified are plainly excessive given that carriers need not and do not purchase "new" equipment, but instead use their own warehoused equipment or other carriers' used equipment for new payphone installations or replacement of existing equipment. This change in market conditions is further underscored by the decrease in the number of viable payphone manufacturers and vendors. These realities are nowhere reflected in the estimate of equipment costs identified by the RBOC Study or by the APCC Study.

25. Indeed, AT&T estimates that the equipment costs associated with 12,000 payphone units that it deploys in military bases are significantly lower than the equipment costs identified by the RBOCs and APCC. With regard to these payphones, AT&T typically does not purchase "new" equipment, but instead uses its own warehoused equipment that has been fully or largely depreciated for new installations. Additionally, AT&T has purchased and sold used equipment at deep discounts from the price of "new" equipment identified by APCC and the RBOC Coalition. AT&T and other IXCs should not be required to subsidize real or apparent inefficiencies associated with the RBOC and APCC members' equipment costs.

I, Hans Heymann, declare under penalty of perjury that the foregoing is true and correct.

Hans Heymann

Executed on January 7, 2004

Attachment B

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
RBOC Payphone Coalition Petition for Rulemaking To Establish Revised Per-Call Payphone Compensation Rate	)	RM No. 10568
American Public Communications Council Request To Update Default Compensation Rate for Dial-Around Calls from Payphones	)	

DECLARATION OF ROBERT M. BELL

I. QUALIFICATIONS.

1. My name is Robert M. Bell. My business address is AT&T Labs-Research, 180 Park Avenue, Florham Park, New Jersey 07932.

2. I received a Ph.D. in Statistics from Stanford University in 1980.

3. From 1980 to 1998, I was Senior Statistician at RAND, a non-profit institution that conducts public policy analysis. While at RAND, I supervised the statistical design and/or analysis of many projects, including several large multi-site evaluations. I also headed the RAND Statistics Group from 1993 to 1995 and taught statistics in the RAND Graduate School from 1992 to 1998. In 1998, I joined the Statistics Research Department at AT&T Labs-Research, where I am a Principal Member of Technical Staff. My main research area is survey research methods.

4. I have authored or co-authored 50 articles on statistical analysis that have appeared in a variety of refereed, professional journals. I am a fellow of the American Statistical Association. I am currently a member of the Committee on National Statistics organized by the National Academy of Sciences as well as the Academy's Panel to Review the 2000 Census.

II. ANALYSIS OF PER-CALL COST STUDY FOR DIAL-AROUND CALLS SUBMITTED BY THE AMERICAN PUBLIC COMMUNICATIONS COUNCIL ("APCC").

5. I have reviewed the "Per-Call Cost Study for Dial-Around Calls" (APCC Study), submitted by APCC in connection with its Request that the Commission Issue a Notice of Proposed Rulemaking (Or in the Alternative, Petition for Rulemaking) to Update Dial-Around Compensation Rate (APCC Request).

6. The APCC Study purports to justify APCC's request for a significant increase in the default rate for dial-around payphone calls by claiming that the results of APCC's survey show that there has been a decrease in the call volumes at "marginal" payphone locations.

7. My understanding is that, in the *Third Report and Order*, the Commission defined a marginal payphone location as one where "the payphone operator is able to just recoup its costs, including earning a normal rate of return on the asset, but is unable to make payments to the location owner."[1] The Commission then established the default compensation rate for dial-around payphone calls by dividing the monthly joint and common costs for a typical payphone by the number of calls placed at a marginal location. *Id.* ¶ 191.

[1] Third Report and Order, and Order on Reconsideration of the Second Report and Order, *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, 14 FCC Rcd. 2545, 2607, ¶ 139 (1999) ("*Third Report & Order*").

8. The APCC Study claims to employ the same methodology. *See* APCC Study at 5 ("The Commission's marginal location analysis is applied in this cost study."). In reality, however, the APCC study is not faithful to the Commission's approach. Instead, it uses a different methodology that skews downward the number of calls (and upward the resulting default rate).

9. In particular, according to the Commission's definition, a marginal payphone must meet two conditions: (1) it recoups costs (plus a nominal rate of return), and (2) it does not earn enough to pay a commission to the location owner. *Third Report & Order* ¶ 139.

10. For the APCC Study, however, a payphone must meet only the second condition to be deemed "marginal." *See* APCC Study at 5 ("Results are reported for these 'marginal payphones' (the average per-payphone costs and average number of calls at payphones for which no commissions are paid to the premises owner)."); APCC Petition at 12 ("Based on responses to those questions, 108 marginal payphones (i.e. those for which no commissions are paid to the location owner) were identified from among the 410 payphones for which responses were received. . . . Only those marginal payphones were used in the cost analysis underlying the rate proposed by this petition."). The APCC Study did not further screen this group to ensure that it was analyzing only those payphones that recoup their costs.

11. Consequently, the survey sample of 108 payphones that the APCC Study labels as "marginal" contains not only phones the Commission would consider marginal, but also some unspecified number of payphones that may not currently recoup their costs. For example, some of the payphones may be "semi-public" phones that are subsidized by a premises owner

who wishes to provide a payphone for customers and pays rent to the payphone provider. *Third Report & Order*, ¶ 156.

12. This error is critical because the set of payphones that do not recoup their costs almost certainly has much lower call volumes on average than the set that APCC correctly classified as marginal. For example, assume that one-half (54 of the 108) of the payphones classified as marginal were classified correctly, while the other 54 failed to recoup costs, so that they were not truly marginal. In addition, assume that the average number of calls per month for the former group was 400 and for the latter group was 68. In this hypothetical, the average number of calls across all 108 payphones would be 234 (the same as in the APCC study). However, the correct average, that for the 54 truly marginal payphones, would be 400, more than 70 percent higher than the number APCC puts forward.

13. Above and beyond the almost certain bias resulting from APCC's error in identifying the marginal payphones, there are several other potential sources of bias. The response rate to the survey was only 43 percent (408 of 940). Nonresponse error "occurs when a significant number of people in the survey sample do not respond to the questionnaire *and* have different characteristics from those who do respond, when these characteristics are important to the study."[2] The large amount of nonresponse in the APCC survey means that there is the potential for large biases in the results of the survey. A second critical concern is measurement error for determining each of: whether a payphone paid any commissions, the operational costs, and the call volume. Those measures all need to have been collected in a reliable, unbiased manner.

[2] Don A. Dillman, *Mail and Internet Surveys*, at 10 (2d ed. 2000).

14. These concerns are heightened by the fact that the subjects of the survey had direct interests in its outcome. Survey respondents—and nonrespondents—stood to benefit if the APCC study showed a low volume of calls and high costs. It is critical that the behaviors of respondents (either the decision to respond or decisions about what to say) were not influenced by this incentive. Here, they were clearly aware of that incentive. The first sentence of the instructions informed potential survey respondents that the data were being collected to "develop a rate for dial around compensation to be proposed to the FCC." APCC Study at D.5.2. Later, when respondents reached the questions on call volume, they were reminded "[t]he FCC methodology is based on the average number of all calls for a given ANI, including all call types." APCC Study at D.5.3. The fact that survey respondents were aware that they stood to benefit from their survey answers regarding costs and call volumes further undermines the validity of the APCC Study.

15. Finally, the APCC Study provides no indications about the size of sampling variability. Although a quantification of sampling variability would not account for the other types of error discussed above, the authors still should have reported either a standard error or a confidence interval for the average call volume and for the average costs per payphone.

III. CONCLUSION.

16. The APPC Study is riddled both with known as well as likely errors that could bias the findings. Such errors include the erroneous inclusion of payphones that are not marginal, nonresponse error, and other potential measurement errors. Consequently, the APCC Study is insufficient to justify the rate increase that APCC seeks.

I, Robert M. Bell, declare under penalty of perjury that the foregoing is true and correct.

Robert M. Bell

Executed on October 29, 2002